Definitions of Accounting

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1.) Accounting

It is an information and measurement system that identifies records and communicates relevant, reliable and comparable information about organization's activities. (K.D Larson)

2.) Book Keeping

It is recoding of transactions manually or electronically. This is just one part of accounting.

3.) Financial Accounting

The area of accounting serves external users by providing them financial statements.

4.) Managerial Accounting

The area of accounting serves that serves the decision making needs of internal users.

5.) Generally Accepted Accounting Principles (GAAP)

Financial accounting practice is governed by concepts and rules known as generally accepted accounting principles.

GAAP aims to make information in financial statements relevant, reliable & comparable.

6.) Principles Of Accounting

Basic assumptions, concepts and guidelines for preparing financial statements.

i. Objectivity Principle

It means that accounting information is supported by independent, and unbiased evidence.

ii. Cost Principles

It means that accounting information is based on actual cost. It means if cash is given for a service, its cost is measured as the amount of cash paid.

If something is exchanged, cost is measured as the cash value of what for what is given up or received.

iii. **Revenue Recognition Principle**

It provides guidance on when a company must recognize revenue.

iv. **Going Concern Principle**

Accounting information is based on assumptions that the business will continue operation instead of being closed or sold.

v. **Monetary Unit Principle**

It means we can express transactions and events in monetary units.

vi. **Business Entity Principle**

It means that business is accounted for separately from other business entities and from its owner.

7.) Forms of Business Entities

i. **Sole-Proprietorship**

A Business owned and controlled by one person.

ii. **Partnership**

A business owned by two or more persons, who agree to share profit & losses and operate a business.

iii. **Corporation/ Company**

A business legally separated from its owners. Business is responsible for its own acts and debts. Its owners called shareholders, are not personally liable for its acts and debts. It is operated through managers.

8.) Assets

The resources owned and controlled by a business. These resources are expected to provide future benefits.

Examples: Land, Building, Equipment etc.

9.) Liabilities

Liabilities are the debts or obligations of a business.

Examples: Accounts payable, Salaries payable, Notes payable, Bank loan etc.

10.) Capital/Owner's Equity

The assets provided by owner to the business is called owner's Equity. It is the owner's claim on assets.

11.) Revenue

The price of goods sold or services provided by a business to its customers.

These are the assets earned from a company's earning activities.

Examples: Sales revenue, Interest revenue, Fee earned

12.) Expenses

The costs of assets or services used up to earn revenue.

Examples: Salaries Expenses, Utilities Expenses, Insurance expenses, Rent Expenses etc.

13.) Net Profit/ Net Income

The amount of Excess revenue over expenses is called profit.

Net Profit = Revenue – Expenses

14.) Owner's withdrawals/ Drawing

The assets an owner takes from business for personal use are called owner's withdrawals.

15.) Purchases

When saleable goods are bought in a business it is called purchases. Example: when a cloth dealer buy cloth, it is purchases from him.

16.) Cash Purchase

If goods are purchased and payment is made at the time, such purchases are known as **cash purchases.**

17.) Credit Purchases

If goods are purchased and payments is to be made at the some future date, such purchases are called **credit purchases.**

18.) Sales

When goods are sold at some specific price it is called **sales.**

19.) Cash Sales

When goods are sold and price is received at the same time, it's called **cash sales.**

20.) Credit Sales

When goods are sold and price is received at some future date, it's called **credit sales.**

21.) Debtors/Accounts Receivable

Amount due from customer for credit sales is called **account receivable.**

22.) Amount Payable/ Creditor

Liability created by buying goods on credit is called **account payable.**

❖ The person to whom amount is paid is called **creditor**.

23.) Transaction

A business event which can be measured in terms of money and changes the financial position of business is called **transaction.**

24.) Depreciation

The process of allocating to the cost of a plant asset over the accounting periods that benefit from its use.

25.) Accounting Period

It is a spam of period for which a business generally prepared its functional statements. Mostly the financial statements are prepared for one year but they may also be prepared for one month or a quarter.

26.) Financial Statements

i. <u>Income statement:</u>

It describes revenue and expenses along with the net income or loss of a business over a period of time.

ii. <u>Balance Sheet:</u>

It describes financial position of a business at a point in time. It shows assets, liabilities, and equity.

iii. <u>Statement of owner's Equity:</u>

It explains changes in equity from net income/loss from owner investments and withdrawals over a period of time.

27.) FIFO Method

The FIFO means **First in First Out**, under this method, the cost of the first purchase is charged to cost of goods sold and cost of last purchase is charged to ending inventory.

28.) LIFO Method

The LIFO means **Last in First Out**, under this method, the cost of the last purchase is charged to cost of goods sold and cost of first purchase is charged to ending inventory.

29.) Trade Discount

The discount given on list price if goods is called trade discount.

30.) Cash Discount/Purchase Discount

The discount given to a creditor on early payment is called Discount.

31.) FOB Shipping Point

FOB means (free on board), under this term the transaction cost is paid by buyer.

32.) FOB Destination

Under this term the transaction cost is paid by seller.

33.) <u>2/10, n/30</u>

It means 2% discount is given if payment is made within 10 days, otherwise full payment is made within 30 days.

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